

Housing Finance in the United Arab Emirates

By Mark Boleat, President, Boleat Consulting

www.boleat.com

Introduction

The United Arab Emirates was formed in 1971 by seven formerly independent sheikhdoms.

Population 2003

| | |
|----------------|-----------|
| Abu Dhabi | 1,591,000 |
| Dubai | 1,204,000 |
| Sharjar | 636,000 |
| Ajman | 255,000 |
| Ras Al-Khaimah | 195,000 |
| Fajairah | 118,000 |
| Umm-Al-Quiwan | 62,000 |

The country is a true federation with the individual Emirates having a great deal of autonomy. Indeed, they are generally viewed as "City States". They compete with each other to attract business and in a number of respects have quite different characteristics.

Each of the Emirates is run by its ruling family with no parliamentary system. The result, however, has been a very stable political structure combined with well run government services, both of which have been essential to attract international business.

The key feature of the Emirates is that the population is predominantly non-nationals. Emirate nationals comprise just 20% of the total population. The population has been growing rapidly at around 6% a year, almost entirely as a result of immigration. Foreign nationals are recruited to work in all parts of

the economy, from construction to transport to financial services.

The UAE is a very wealthy country, largely thanks to oil. The economy has grown rapidly, if erratically, and inflation has been under 3% for the last five years. The general level of interest rates is low. The three-month interbank rate has been under 2% since 2002 and bank lending rates have fallen to under 6%.

Housing and housing finance for UAE nationals

The UAE has plenty of money to look after its residents. In practice, most nationals have been housed by the State and nationals have little need to borrow large amounts to fund their housing. The State has built housing directly and given it to nationals. However, the circumstances in which the properties can be resold are severely restricted and they cannot be mortgaged.

Low and middle income people are entitled to a 15,000 sq ft plot of "granted land". Those earning under AED120,000 (\$33,000) a year are also entitled to a grant of AED500,000 (\$136,000) to pay for the design and construction of a home. People with incomes in excess of AED120,000 are entitled to an interest free loan over 25 years of between AED500,000 and AED750,000. They can top up this loan with personal loans from commercial banks.

The opening of the market in Dubai

Until recently, it was not possible for non-nationals of the UAE (and with some restrictions nationals of Gulf Co-operation Council countries) to own property. In 2002, the government of Dubai announced that non-nationals and non-residents would be allowed to own housing on a freehold basis. The announcement has been followed by a dramatic take off in the housing market with both demand and supply rising very rapidly. The way that this has happened and the way that house purchase has been financed is probably unique in the industrialised world.

This initiative by Dubai needs to be seen in the context of the Dubai economy generally. The Government is planning a massive expansion of the economy including new facilities in trading, tourism and financial services. There is a liberal business environment and low taxes, all designed to encourage entrepreneurial activity. The population is planned to increase from 1.2 million to over 2 million by 2010.

There is no doubt that in 2002 there was a huge pent up demand among long term non-national residents in Dubai to purchase their properties. Many had been living in Dubai for years and fully intended to make it their home for life. They had been paying rents at a very high level which would have paid for the cost of their housing perhaps several times over. To these people the opportunity to own was gratefully received and many were among the initial purchasers of properties.

At the same time, a number of other factors contributed to make Dubai an attractive place in which to own a property and to have residency. As a direct consequence of 9/11 much money owned from within the Middle East was repatriated from the United States and other foreign markets and was looking for a home. The Dubai property market has provided such a home. Dubai has also been attractive to nationals from the Middle East, particularly Iran, and the Indian Sub-Continent, as a result of its strength as a business and financial centre, low tax regime, good quality of life and physical location.

The government did not confine itself to stimulating demand. It also took positive steps to provide a supply of housing to meet the demand. The tactic has been to designate large zones as being available for housing to be owned by non-nationals. Three developers, all effectively backed by the State, Emaar Properties, Nakheel and Estithmaar, have led the developments on the designated zones. They have had the benefit of land being "gifted" to them by the State.

The developments are not of single units but rather of massive estates comprising both apartments (particularly in the coastal areas) and villas, together with all the supporting infrastructure and facilities such as golf courses, marinas, shopping malls and restaurants.

It is helpful to note some of the major developments and also the pricing of them.

Emaar's projects include –

- Dubai Marina, described as a "city within a city", comprising 1,026 apartments and 64 luxury villas. The apartments' prices range from AED488,000 (\$133,000) to AED1,050,000 (\$286,000). Eventually there will be 19,000 units at the Marina.
- A number of developments under the general heading of "Emirates Living". These include the prestigious Emirates Hills development comprising 640 single family detached villas, together with a

golf course, and four other developments. These developments will have a total of 9,000 units.

- Burj Dubai, which will be the tallest tower in the world. The apartments will be in six towers and provisionally prices range from AED600,000 (\$163,000) for one bedroom apartments to up to AED2 million (\$545,000) for the largest apartments.

Estithmaar has just one development, Jumeirah Beach Residence, which comprises 36 residential towers with 6,400 apartments and four hotel towers with 4,000 rooms. Prices range from AED315,000 (\$86,000) up to AED1,200,000 (\$327,000) for four bedroom apartments.

Nakheel Properties is best known for its projects that are offshore, built on reclaimed land. The Palm Jebel Ali has already been completed, villas and town houses having been sold at prices ranging from about AED2 million (\$545,000) to AED5 million (\$1,360,000). The Palm Jumeirah is a similar development. The Palm Deira was announced in November 2004 and is already being marketed in the UK. The individual islands will be for sale and the purchasers can then do what they like on them. Nakheel is also building Jumeirah Village, comprising 7,000 villas.

Almost all of the developments are sold out almost immediately they go on sale and generally well before construction has started let alone been completed. In 24 hours in September 2004, Nakheel sold all 7,000 villas in Jumeirah Village. The developers differ to some extent on their requirements for deposits and stage payments. Nakheel requires a 15% deposit and then regular payments during construction. Emaar requires most of the purchase price to be paid on completion. Estithmaar has required four payments of 25% at various stages of the process.

However, as yet, no land law has been enacted in Dubai and purchasers are not able to register title to their property and cannot raise finance to purchase the property by means of a conventional

mortgage loan. It is therefore a very interesting question as to why the market has taken off.

The developers clearly trust that the market will continue booming as they are still involved in massive developments. On the whole, house buyers trust the major developers as they are in effect part of the State. The developers give a "certificate of beneficial ownership" and in effect run their own title registration services, in co-operation with the official Lands Department. There is total confidence that the developers will not go bust and that they will not treat purchasers badly.

There is a further element of trust in that there is a general belief that the law will be changed so that the purchasers of property will have full legal title and not just the security of a sale and purchase agreement with a developer.

Finally, and perhaps most importantly, purchasers have confidence that the market will continue its rapid rise and that they are bound to make a profit. This confidence in the market, combined with trust in the developers, has been more than sufficient to outweigh what are regarded as legal technicalities which will soon be put right.

The normal pattern is for developments to be sold off plan with the purchaser putting down just a 10% deposit. With the expectation that prices will continue rising, this has resulted in many speculators coming into the market, buying blocks of properties and then reselling them at a significant profit. Some of the developers are sufficiently concerned about this that they have taken steps to prevent it, for example by increasing the deposit or by requiring more prompt payment of the full purchase price.

Financing house purchase

In an advanced industrialised economy such as Dubai it would be normal to expect that commercial banks would finance house purchase as part of their mainstream business. However, banks, particularly

international banks, have a particular mindset when it comes to financing house purchase. The basic requirement is that the bank should have a mortgage on the property such that if the borrower defaults then the bank has the property as security and can recover its loan. Banks also seek other reassurance, for example that if the developer defaults during construction the borrower is protected, that there are accepted appraisal standards and also that the necessary legal processes and procedures are in place to ensure that the purchaser has good title to the property and that the bank's rights as mortgagee are protected.

None of these conditions were fulfilled and therefore the commercial banks were unwilling to finance house purchase other than through a limited amount of personal loans which in any event can be for no more than AED250,000 (\$68,000).

In practice, there has not been a huge demand for loan finance. Many of the developments have yet to be completed and accordingly in some cases only the initial deposit has been paid. Most of the properties have been bought by speculators who have not needed to borrow. Where people have bought for their own occupation, they have often done so precisely because they have surplus funds. It is probably the case that for properties bought for occupation fewer than 20% have required loan finance and where loan finance has been needed this is for less than 60% of the purchase price.

Because Dubai is an entrepreneurial economy the reluctance of the banks to provide loans to finance house purchase quickly resulted in alternative mechanisms, mainly in the form of specialist finance companies established by the developers.

Recognising the need for loan finance, Emaar took the initiative to establish its own mortgage lending company, Amlak in 2002. The company has obtained all of its funding from its parent, Emaar Properties, although it plans to raise funds from other sources as well. In 2004, the company floated through an initial public offering in which 55% of the

shares were offered to the public, the remaining 45% being retained by Emaar. This increased its issued share capital to AED750 million (\$204 million). In October 2004 the company was capitalised at AED2,295 million (\$625 million).

Purchasers of houses built by Emaar Properties are directed towards Amlak although they are free to borrow from other sources. It is estimated that Amlak finances about 10-20% of all Emaar sales but probably about 90% of those which require loan finance. Amlak's outstanding loans at the end of 2003 were AED128 million (\$35 million). By the end of 2003 the figure had increased to AED531 million (\$145 million).

Amlak has provided fairly conventional loans for house purchase, its average loan to price ratio being around 60-65%. Amlak is in the process of transferring its entire mortgage business to a shari'a basis. That is, instead of the borrower being charged interest, Amlak technically owns the property, leasing it to the "purchaser" and transferring the property to the purchaser at the end of the lease period. In practice, the effect is the same as a conventional mortgage loan. The lender has more security in the event of default because it owns the property.

Amlak were first in the market and probably accounted for well over half of loans to finance house purchase in 2003. Its market share can be expected to fall over time as other financial institutions enter the market. It is seeking to diversify its mortgage business and will now lend to purchasers of developers other than Emaar.

Tamweel is similar to Amlak in many ways and was set up by Nakheel which has a 50% shareholding. The remaining 50% is owned by the Dubai Islamic Bank. Nakheel was established in 1997 and currently has AED270 million (\$74 million) capital. The company is intending to make a public offering of its shares. Although it was established by Nakheel, it will lend on properties built by any of the developers. Tamweel is operated entirely on an Islamic principle.

How the market will develop

The housing finance market in Dubai can be expected to go through a period of evolution that can probably be predicted with reasonable accuracy. Because there was a huge demand for housing finance that the banks were unwilling to meet, other institutions, notably Amlak and Tamweel, have come into the market. They have demonstrated that there is a big market and that the lending, so far at least, is safe and secure, notwithstanding the unsatisfactory legal framework. The mainstream banks recognise that this is a market they cannot afford not to be in and that they might risk losing their customers to banks that provide housing finance services, particularly given that it is a common practice for banks to require that salaries are paid into an account with the bank as a condition of making a housing loan.

Not surprisingly, the mainstream banks are now looking at entering the market and a number of banks, particularly HSBC, have taken positive steps. It is to be expected that the banks will continue to take a market share, particularly if the issues on property law and residency are resolved satisfactorily. Amlak, in particular, has already demonstrated its desire to diversify both internationally and domestically and can be expected to become more like a mainstream bank. Both Amlak and Tamweel will move away from their close links with particular developers. It is possible that the mainstream banks will consider an alliance of some form with either Amlak or Tamweel.

Assuming there are no great shocks in the market, it is reasonable to predict that within five years or so the bulk of new funding for home loans will come from mainstream banks with specialist lenders having niche positions in the market.

As the market expands, and if the legal issues are satisfactorily resolved, then the mortgage rate can be expected to decline. At present the 6.5% variable rate for mortgage loans looks high in relation to the cost of funds. It should fall if bad debt experience is minimal and as unit

administrative costs decline with the rising volume of business. Shuaa Capital is forecasting that Amlak's cost income ratio will fall from 32% in 2003 to 10% in 2007, a good indication of how a rising volume of business reduces costs.

This article is an abbreviated version of a report commissioned by Barclays Bank and endorsed by the Central Bank of the UAE. A copy of the full report is available on the author's website www.boleat.com. The views expressed in the report are those of the author alone and not those of Barclays bank or the Central Bank of UAE.

References

- Amlak, *The prospectus*, 2004.
- Dubai *Property investment guide*, Cross Border legal Publishing, 2004.
- IMF, *United Arab Emirates: Financial System Stability Assessment*, IMF Country report No 03/20, 2003.
- Shuaa Capital, *Amlak Finance*, Equity Research 2004.
- Shuaa Capital, *Emaar Properties*, 2004.